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Noble Ends Flawed Means:

The Case Against Debt-Forgiveness

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EXECUTIVE SUMMARY

In 1996, the IMF and the World Bank asked their member governments to fund the Heavily Indebted Poor Country (HIPC) Initiative that purports to 'forgive' the 'excessive' debt of 40 developing countries. The Initiative has been followed up by an even broader plea for debt forgiveness by the Jubilee 2000 coalition of non-government organisations and many church groups, who have called for the outright cancellation by December 2000 of the Third World's unpayable debts.

The two papers contained in this *Issue Analysis* suggest that *the proposals for debt-forgiveness advanced by these groups are flawed in design, morally questionable, and are most likely to have negative effects upon the very countries that debt-forgiveness is intended to help.*

Examining the Jubilee 2000 proposal, the first paper points out that many Christian supporters of Jubilee 2000 ignore many of the negative consequences that debt-forgiveness is likely to have upon the developing nations' economic future. Debt-forgiveness is likely to undermine the developing nations' reputation for meeting their contractual obligations and consequently limit their future access to the foreign capital that they require for economic growth. Much of the moral argumentation of Jubilee 2000's Christian supporters is also questionable, not least because aspects of Jubilee 2000's proposals significantly violate some important criteria of distributive justice.

The second paper analyses the HIPC Initiative instigated by the IMF and World Bank. It notes that most HIPC governments have exploited their countries for the narrow personal gain of ruling elites, and spent much of the debt incurred on buying military equipment to use against their own populations and those of neighbours. The HIPC Initiative, however, does nothing to discourage further irresponsible use of borrowed monies by HIPC governments, raises the costs of borrowing for developing countries who have used their loans wisely, and effectively disguises the failure of the World Bank and IMF to enforce the conditionality that they originally attached to loans. ■

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THE CENTRE FOR INDEPENDENT STUDIES

FORGIVE US OUR DEBTS?
JUBILEE 2000:
The Unanswered Questions

Ian Harper and Samuel Gregg

Introduction

Various community groups have banded together under the banner of the 'Jubilee 2000 Campaign[1]' to call for the outright cancellation by December 2000 of the Third World's unpayable debts. The campaign received particular impetus from the decennial Lambeth Conference of the world's Anglican bishops held in Britain in 1998, and also from the meeting of G8 finance ministers held in Cologne in June 1999. At the latter meeting, a petition signed by 20 million people from around the world was handed to delegates while large numbers of supporters of Jubilee 2000 descended on Cologne to voice their demands for debt forgiveness.

At first sight, it seems reasonable for all people, religious or otherwise, to support Jubilee 2000. We are all haunted by the images of large-eyed starving children that appear on our television screens. There is no question that the intentions of the Jubilee campaigners are honourable. No morally sentient person could fail to be moved by the plight of the poorest inhabitants of the poorest countries on earth.

From a Christian perspective, there are *profound flaws* in the economic and moral arguments presented by Jubilee 2000 to which there has yet to be an adequate response.

This paper, however, suggests that, from a Christian perspective, there are *profound flaws* in the economic and moral arguments presented by Jubilee 2000 to which there has yet to be an adequate response.

In this regard, it should be noted that there is, in fact, *no such thing as a single Christian strategy for alleviating poverty in underdeveloped countries* to which all Christians are expected to adhere. Christians are certainly obliged to love those who are spiritually and materially poor, and to help redress their circumstances. When it comes, however, to *how* heavily indebted countries should be assisted, there is significant room for debate, discussion and legitimate disagreement among Christians. As no less an authority than the American theologian Germain Grisez points out:

> On many matters . . . faithful [Christians] can legitimately disagree. In some situations, those exercising political power are open only to options incompatible with the Church's teaching, and the question is which of those options should be considered worse and so opposed in order to mitigate the evil. In other situations, there are two or more positions, incompatible with one another but compatible with the Church's teaching. In both kinds of cases, even though someone has arrived at a position by applying the Church's teaching to the facts of the problem as carefully as possible, he or she should not propose that opinion as the Church's teaching (Grisez 1993: 860).

Some Guidelines for Christians

In considering a subject such as Third World indebtedness, Christians should keep three points in mind. The first is the point of the exercise. 'What', Christians should ask, 'is the ultimate object that we should have in mind?' A moment's reflection soon indicates that *the primary aim is not debt-relief in itself.* Outright debt forgiveness is simply a *means* by which some people believe–erroneously in our view–that the economic underdevelopment of these countries may be redressed/remediated.

The second point is an age-old principle that Christianity has always affirmed: that is, *the ends do not justify the means*. Determining, of course, whether or not pursuing certain means to an end involves formal cooperation in moral evil is often a difficult and lengthy exercise. There is, however, much evidence to suggest that outright debt forgiveness is a morally and economically suspect means to a laudable end.

Thirdly, in thinking about a question as complex as Third World poverty, it is not enough for Christians to refer only to Scripture or other traditional sources of Christian

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[1] The term 'Jubilee' comes from the Jubilee law outlined in Leviticus 25 which concerns Israelites forgiving each other's debts every 50 years.

morality when seeking guidance as to how they should act when faced with problems as complex as Third World poverty. If Christians are serious about loving God 'with all their minds' then *they cannot ignore the evidence offered by intellectual disciplines such as economics and history* when thinking about such issues.

This is not to say that Christians should think about Third World poverty solely or even primarily from the viewpoint of, for example, economic science. If, however, they wish to contribute wisely to the debate, they cannot disregard what disciplines such as economics and history tell us is likely to occur as a consequence of outright debt forgiveness. For those who advocate policies without knowing the full range of costs and benefits are ignorant, and anyone who supports policies knowing but not articulating these costs and benefits is simply disingenuous. While an appeal to emotions has the power to stir people to action, it does not guarantee that the action taken will improve the circumstances that the campaigners earnestly hope to remedy. Indeed, in the crude form advanced by many Jubilee 2000 supporters, debt forgiveness could well leave the poorest countries considerably worse off than they already are.

Hard Facts

One of the first presumptions made by Jubilee 2000 is that creditor agencies–be they international bodies or governments–would forgo their entitlements under the debt-contracts without being dissuaded from future lending to these same debtors. Such an assumption is extremely questionable. A key economic issue here is one of confidence and credibility. *A credible reputation for servicing one's contractual obligations is a country's greatest asset in the international financial market.* Do Jubilee 2000 proponents seriously wish to undermine the debtor countries' reputations for meeting their obligations and thereby damage their prospects of access to foreign capital?

Another key concern is that unconditionally forgiving debts fails to address the long-term underlying problems that impede the economic development of the world's poorest countries. The *only* long-term solution to poverty is economic growth. This systematically advances the material welfare of all inhabitants of a country, even if it occurs at variable rates. The miraculous rates of economic growth experienced in East Asia over the past four decades have raised the material living standards of millions of human beings above grinding poverty. Community standards of health, education and general wellbeing have risen beyond the wildest expectations of the post-World War II generation.

To repeat this miracle in Africa, where many of the world's poorest countries are located, requires much more than debt forgiveness. Developing countries need capital and they usually cannot accumulate it from their own resources. They need to rely on foreign capital in some form, be it debt or equity capital (Borensztein 1995). This is true even of rich countries like Australia which are still 'developing' in the sense that valuable investment opportunities are being actualised, the returns from which will enrich Australians and foreign investors alike.

But allowing heavily indebted nations to walk away from their debts sends precisely the wrong signal to the community of international lenders. What confidence can they have to lend more funds when their own or other lenders' funds have been confiscated arbitrarily? If lenders can never be sure that their funds will be returned, how will poor countries develop sustainable access to international capital markets, which is a prerequisite of long-term economic growth? Poor countries need to develop reputations as responsible borrowers who not only deploy the borrowed funds productively but who also repay their debts as contracted. How will debt cancellation help poor countries achieve either of these goals?

Indeed, the history of many heavily-indebted Third World countries indicates that the expectation must be that the funds released from debt cancellation will *not* be deployed productively–at least not without the imposition of conditions. Yet when arguing their case in the raw form calculated to attract maximum public attention (i.e., the 15-second sound bite), Jubilee 2000 supporters rarely say anything about conditionality. In the more extended versions of their proposal, the need for conditions is conceded–albeit grudgingly–and in a less onerous form than traditionally applied by multilateral institutions. Yet we know that the 'harsher' forms of conditionality applied by the IMF and World Bank have proved insufficient in many cases to preclude wasteful

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and corrupt expenditure of loan monies in the past. This partly explains why the poor countries are in their current predicament. How, then, will *easier* conditions, let alone none at all, improve the situation?

The Moral Dimension

Failure to address the facts outlined above is, however, only part of the problem with Jubilee 2000's campaign for debt forgiveness. From the standpoint of Christian ethics, many questions have yet to be answered.

In the first instance, the very fact that many Jubilee 2000 promoters avoid discussing the complex issue of conditionality in public is questionable in itself. The usual response to this criticism is that to do so would not be conducive to getting Jubilee 2000's message across to the public in the age of the 15-second sound bite. While this may be true, the result of such tactics is that people are effectively misled into supporting something about which they have not been fully informed, and which they might otherwise refrain from supporting if they were aware of all the facts. Moreover such messages not only trivialise the long-term nature of the economic development problem by implying that debt cancellation is a panacea, but also do great disservice to the inhabitants of poor countries whose real needs are ignored as the attention of wealthy Westerners is diverted to the wild goose chase of debt cancellation.

Secondly, many Christian supporters of Jubilee 2000 sometimes utilise biblical references in an often simplistic manner to support their case. The biblical verses to which reference is usually made are contained in Leviticus 25, which tells us that it was customary for Israelites to cancel all debts every fifty years and return all land to its original owners.

The burden of debt canc-ellation will not fall upon the wealthy West but upon other developing countries.

Certainly, Christians may correctly infer from these verses that the principle of debt-cancellation is, in itself, acceptable. But this does *not* mean that the same principle should be applied uniformly and without exception to highly indebted poor countries at the end of the twentieth century. For one thing, careful reading of the Jubilee law indicates that its purpose was not to encourage the development of a type of property-less utopia or the development of a society in which there are no wealth-differences. Rather it 'stresses and safeguards the function of private property as an *incentive* to industrious energy' (North 1954: 163). As the biblical scholar John Hartley notes:

> The Jubilee manifesto has not been lost on the pages of a forgotten Old Testament book. It has had a leavening effect on social thought in the West. . . . [It] has contributed to the Western idea that every family has a right to own property. The view of land ownership herein, however, is revolutionary. . . . It promotes responsible work that attends ownership of property, and at the same time it promotes responsible brotherhood of all Yahweh's people (Hartley 1992: 447-448).

Leviticus 25, then, is about more than debt forgiveness. It is also about creating incentives and encouraging *responsible* brotherhood. But by ignoring the hard economic facts outlined above, it is arguable that Jubilee 2000 does little to realise either of these aims.

Thirdly, Jubilee 2000 campaigners often imply that debt cancellation will be funded from the capacious pockets of the West. The facts are, however, that Western aid budgets are at a low ebb. The resources of the multilateral agencies are also stretched to the point that their capacity to fund debt cancellation from internal resources is non-existent (Boote and Thugge 1999). This means that the funds foregone by cancelling the debts of the poorest countries will have to be raised from other aid recipients. *The burden of debt cancellation will not therefore fall upon the wealthy West but upon other developing countries*: not upon the poorest of the poor perhaps, but the poor nonetheless. Their aid budgets will shrink and their loan allocations will be cut.

Surely this violates some basic criteria of distributive justice. Contrary to much received opinion, distributive justice involves much more than equality. It also entails assessment of other factors such as deservedness, as well as gauging who has assumed some responsibility for their situation and who has not chosen to do so (Finnis 1980: 173-177).

In this light, the actualisation of Jubilee 2000's proposals for debt cancellation will amount to nothing less than a case of rewarding countries who cannot or will not repay debts by taxing those who can and are. While it may be argued that the poorest countries deserve compassion irrespective of the grounds of their plight, self-inflicted or otherwise, where is the moral case for imposing the burden of such compassion on others in a less onerous but nonetheless perilous position? Is it not questionable that some First World Christians speak passionately about the plight of the poor while advocating a remedy that will place new burdens upon those who are also poor? Where is the call from Jubilee 2000 campaigners for rich Western Christians to open their wallets or press their governments to fund debt forgiveness?

Advocacy of debt forgiveness is surely morally questionable if it effectively shifts the financial burden to others whose past behaviour and present circumstances warrant no such imposition. Certainly, the wrongs committed by corrupt or naïve lenders and borrowers in the past are regrettable, and every attempt should be made to prevent future occurrences and to penalise the perpetrators, be they corrupt Third World dictators or irresponsible International Monetary Fund (IMF) or World Bank officials. But penalising those who had no part in the matter is suspect. Such actions also undermine future efforts to discourage immoral behaviour by effectively rewarding with debt forgiveness those countries whose leaders have been irresponsible borrowers.

Past wrongs will not be righted by an act that could have dire consequences for the debtor nations' credibility in international financial markets.

Fourthly, Jubilee 2000 campaigners sometimes argue that the lenders do not deserve to be repaid since many of the loans were granted for immoral purposes–to fund, for example, military campaigns using Western-supplied weaponry. Some further contend that many First World nations effectively aided and abetted corrupt Third World regimes by lending them large sums that they expected to be spent on purchasing Western military hardware. The citizenry of debtor countries, it is claimed, had no say in these transactions; it is therefore wrong that they should bear the consequences.

Yet while it is probably true that many loan monies were applied corruptly, if not supplied corruptly, it is a *non sequitur* in terms of ethical reasoning to suggest that such behaviour justifies another morally questionable act: i.e., debt forgiveness. Past wrongs will not be righted by an act that could have dire consequences for the debtor nations' credibility in international financial markets.

In this connection, one argument often employed by some Christian advocates of Jubilee 2000 is that lending money to the debtor nations was in itself immoral in the first place. The debtor nations, they suggest, should have been granted outright transfers of monetary capital. Debt forgiveness would thus constitute expiation by lender nations for their sin.

Since medieval times, however, Christianity has recognised that money is not a 'sterile' thing. Money is a form of 'capital'. It can be used to produce new wealth for oneself and others. On this basis, medieval theologians wrestling with the issue of usury argued that it was reasonable for those lending money to charge for forgoing other legitimate uses of their capital (Divine 1959: 3-116; Pacant 1963). More generally, Christianity holds that interest may be charged as a protection against probable inflation, taxes, and risk of non-payment (Grisez 1993: 834). From a Christian perspective, then, to declare the very fact that loans were made to debtor nations as 'immoral' is suspect. Here it should be remembered that direct aid *was* given to debtor nations in the form of finance, human resources and technology. One reason that loans were also made to these countries was to help them acquire a good credit rating in the international financial market–a long-term goal that Jubilee 2000 places in peril.

Conclusion

What, then, is to be done? There may be a case for some debt forgiveness in emergency circumstances, as occurred in Central America this year. From a Christian viewpoint, this could be justified in terms of saving human life that is in imminent danger. More generally, consideration could be given to the plan proposed by Oxfam in which debtor nations willing to direct 85-100 per cent of debt-savings to poverty-reduction initiatives will be given incentives in the form of earlier and deeper debt-relief. While this plan has its own problems, it at least attempts to help the poor directly, provides less scope for corrupt officials or crony-capitalists in developing nations to 'appropriate' the savings, and does not imperil the credit credentials of heavily indebted countries.

As Christians, we are commanded to love our neighbours. This is the very essence of solidarity. But loving our neighbours does not involve advocating well-meaning but simplistic, potentially damaging, and morally questionable solutions to their problems. In dealing with a matter as complex as international debt, Christians need to approach the issue with a soft heart and hard head. Softheaded approaches will only hurt those whom we wish to help.

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SHOULD HEAVILY INDEBTED POOR COUNTRIES' DEBT BE FORGIVEN?

Helen Hughes

Introduction

In 1996, the International Monetary Fund (IMF) and the World Bank asked their member governments to fund the Heavily Indebted Poor Country (HIPC) Initiative that purports to 'forgive' the 'excessive' debt of 40 developing countries. The Initiative has been followed up by an even broader plea for debt forgiveness by the Jubilee 2000 coalition of non-government organisations.

What could be more worthwhile than helping the poorest countries in the world? The cost to industrial countries at US$400 per person surely cannot be regarded as too high. But this is an extremely naïve view. Debt forgiveness would actually harm the countries concerned. The mechanics of the Initiative mean that 56 per cent of HIPC debt would merely be reshuffled to enable the IMF and World Bank to stay in business. The Jubilee 2000 proposal also opens up opportunities for a new spate of irresponsible borrowing.

No-one would dispute that the HIPC countries are clearly 'borrowed up': that is, they have reached levels of indebtedness that cause budget and balance of payments difficulties. But they are not 'borrowed up' because their debts are high, but rather as a result of their failure to follow even modestly prudent economic policies.

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The situation has been worsened by the fact that each dollar borrowed from multilateral institutions was accompanied by 'conditionality' that was totally ignored in practice. Thousands of pages of project and program evaluation weasel-worded the HIPCs' lack of responsiveness to this issue, thereby allowing the multilaterals to go on lending.

Unfortunately, new efforts now made to write new 'conditionality' into debt relief are partial and as easily ignored as in the past. The elite groups would again spend the freed up budget funds for their own benefit. Moreover, they would borrow again, and the poor, who bear the brunt of taxation in these countries, would again be left to pay for the new loans. Debt forgiveness would legitimise incompetent, rapacious and corrupt governments. Even debt repudiation would provide a better indication to past and future lenders that a country is serious about changing its policies, not least because the considerable flows of bilateral debt forgiven in the past have not resulted in any policy changes. For this reason, international efforts should be limited to facilitating a bankruptcy framework.

Australia might participate in such an endeavour, but it should not pay for past and present bilateral or multilateral support of incompetence and corruption. Almost all Australian aid is in grant form. Consequently, Australia's bilateral aid has not contributed to developing country indebtedness. There is no reason why Australia should use its taxpayers' money to bail out countries like Japan and the United States that are responsible for 46 per cent of HIPCs' debt.

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But before outlining the case against debt-forgiveness in detail, it is essential that two points be clarified. The first is the composition of the HIPCs debt; the second is the origins of the HIPC initiative and its characteristics.

The Composition of HIPC Debt

Table 1 (page 8) indicates that private debt is negligible for HIPCs (though the figures are somewhat questionable because military deals are not reported[1]). While some private banks have in the past made loans to governments and individual enterprises in HIPCs during periods of high international capital liquidity, most have not. Those that did, however, found that their loans were not performing. They had to write them off because central banks in their home countries have prudential limits on non-performing loans. Relieving private debt is therefore not an issue.

When it comes to public debt, 46 percent is owed to bilateral donors. Japan is probably the largest debt holder, but is extremely coy about releasing information about its holdings. The United States is probably the second highest debt holder, with some $6.8 billion. This is equivalent to its annual expenditures on economic aid. Much of this debt only exists on paper. The principal sums bear no relation to reality. The United States Government and Congress are currently giving consideration to bilateral aid write-offs and the HIPC Initiative.

The Paris Club has handled substantial reductions in bilateral debt and could handle the reduction of remaining bilateral debt. This is an informal arrangement of a group of donor countries that meet regularly to arrive at a common approach to the restructuring of the debt service on official loans owed to them. Australia, though it is owed a negligible amount of official debt, is a member. Other members are Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Norway, Netherlands, Spain, Sweden, Switzerland, United Kingdom and the United States. A few additional countries attend *ad hoc*.

The other 54 percent of HIPC public debt is owed to the IMF, the World Bank and other multilateral institutions. The Asian Development Bank is not a major lender to the HIPCs. Only three of these countries–Laos (US$2.32 billion), Myanmar (US$5.07 billion) and Vietnam (US$21.63 billion)–are in Asia. Of these, only Vietnam owes a substantial sum.

The HIPC Initiative

The IMF and the World Bank have adamantly refused to forgive any of the debt that they created. Given the fungibility of capital, it has long been clear that IMF and World Bank lending took the form of marginal additions to national budgets. These were rarely the projects and programs for which loans were made. By the 1990s, it was

1 Under the World Bank's Articles of Agreement, the Bank cannot lend to a country unless it has knowledge of that country's debt situation. The World Bank has therefore become responsible for compiling debt data for developing countries. Despite hard and assiduous work by World Bank staff, the debt data for many of the HIPCs (and other countries) are questionable as they do not include most borrowing for military purposes.

Table 1–Composition of Debt ($US) in Heavily Indebted Poor Countries

	Total External Debt $billion	Private External Debt $billion	Exports of Goods and Services $billion	Per capita GNP $	IMF and World Bank Debt as % of Total External Debt	Population Million	Average annual growth of GNP per capita %
Angola	10.16	5.99	5.20	270	1.34	11	..
Benin	1.62	0.00	0.53	350	37.23	6	0.1
Bolivia	5.25	0.47	1.64	830	23.16	8	-0.5
Burkina Faso	1.30	0.00	0.33	230	56.13	11	1.5
Burundi	1.07	0.00	0.10	170	55.75	6	1.6
Cameroon	9.29	0.78	2.44	610	11.97	14	1.4
Central African Rep.	0.89	0.00	0.21	310	47.62	3	-0.8
Chad	1.03	0.02	0.27	160	50.49	7	-0.6
Dem. Rep. of Congo	12.33	0.83	1.46	130	13.9	45	-3.5
Rep. of Congo	5.07	0.83	1.77	670	5.35	3	1.9
Côte d'Ivore	15.61	4.59	4.78	660	16.62	14	0.0
Equatorial Guinea	0.28	0.01	0.49	530	22.28	*	..
Ethiopia	10.08	0.35	1.02	100	16.06	58	..
Ghana	5.98	0.70	1.66	360	50.05	18	-0.9
Guinea	3.52	0.07	0.69	560	28.99	7	..
Guinea-Bissau	0.92	0.00	0.06	250	25.28	1	0.0
Guyana	1.61	0.06	0.78	690	24.50	1	..
Honduras	4.70	0.50	1.67	660	17.00	6	0.5
Kenya	6.49	0.79	2.99	320	38.48	27	1.5
Laos	2.32	0.00	0.42	400	18.28	5	..
Liberia	2.01	0.19	..	..	26.97	2	..
Madagascar	4.10	0.05	0.77	250	31.27	14	-2.0
Mali	2.95	0.00	0.64	240	37.84	10	0.5
Mauritania	2.45	0.02	0.44	470	20.00	2	-0.6
Mozambique	5.99	0.06	0.50	80	22.52	18	..
Myanmar	5.07	0.45	..	..	14.26	46	..
Nicaragua	5.68	0.39	0.80	380	7.38	5	-4.2
Niger	1.58	0.10	0.10	200	43.40	9	-2.8
Rwanda	1.11	0.00	0.11	190	53.86	7	0.1
São Tomé and Principe	0.26	0.00	0.01	320	22.13	*	3.1
Senegal	3.67	0.07	1.48	570	40.67	9	-0.5
Sierra Leone	1.15	0.01	0.12	200	38.21	5	-1.4
Somalia	2.56	0.03	..	..	21.74	10	..
Sudan	16.33	1.97	..	..	12.26	27	-0.4
Tanzania	7.18	0.29	1.26	170	36.02	30	..
Togo	1.34	0.00	0.46	300	48.42	4	-0.7
Uganda	3.71	0.08	0.83	300	63.32	20	..
Vietnam	21.63	4.74	11.48	290	4.72	75	..
Yemen, Rep.	3.86	0.84	2.49	380	30.70	16	..
Zambia	6.76	0.49	1.28	360	39.85	9	-2.0

*Note *Population under 1 million*

Source: World Bank World Tables (electronic) admitted in Washington, first in internal and then in public documents, that the effectiveness of lending depended predominantly on the national policies of the borrowers (Burnside and Dollar 1997; Burnside and Dollar 1998; Dollar and Svensson 1998). The IMF and the World Bank thus feared that even forgiving evidently counterproductive loans made to corrupt governments would not only encourage other countries to seek a lightening of their debt loads, but also open a Pandora's box of debate about the real uses of IMF and World Bank lending.

When the non-government organisations' pleas for debt forgiveness began to attract support, the staff of the IMF and the World Bank prepared the HIPC Initiative in 1996. They proposed that IMF and World Bank staff evaluate the debt burden of low-income countries that had exhausted relief through the Paris Club and other initiatives

Jubilee 2000's proposals for 'new conditionality' are so weak precisely because they say so little about the basic policies and institutions that are essential to growth.

Criteria for Assistance

To be eligible for concessional assistance, a country had to have:

- a per capita GNP of US$695 or less;
- an unsustainable debt burden after all other debt relief options had been exhausted; and
- an established track record of adherence to IMF and World Bank 'conditionality'. Countries were to follow an economic reform program sanctioned by the IMF and World Bank for three years and establish a further three-year record of 'good policy performance'. If strictly interpreted, countries would not be eligible for debt relief for six years.

Initially, 41 countries were deemed to meet these criteria. Significantly, an escape clause granting exemptions from the 6-year evaluation period on a country by country basis had to be introduced if any countries were to be eligible. Past non-conformity was thus ignored. 'Conditionality' was therefore once again fundamentally compromised. After exemptions were exercised, 40 HIPC eligible countries remained.

Creditors' Share of Debt Relief

Multilateral creditors were to provide 54 per cent of HIPC multilateral funding, with the World Bank providing 25 per cent, the IMF providing 9 per cent and donor countries the other 20 per cent. Bilateral creditors were to look after their own debt and private creditors were to take complementary measures.

Burden Sharing

Bilateral creditors were to decide whether to extend their share of debt relief through forgiveness, reduction or rescheduling, making the debt service payments themselves or offering new loans to cover the payment of old loans. The IMF and the World Bank would not forgive debt outright. They have set up special accounts to make debt payments for HIPC countries. The World Bank transferred $US850 million out of the profit on its operations to an HIPC Trust Fund in February 1999. The IMF has allocated US$52 million to an escrow account that is to be used to cover HIPC service payments. As indicated above, bilateral donors are expected to supplement these funds.

More recently, gold sales by the IMF were seen as a possible (and large) source of funding for the HIPC initiative. Gold mining countries, however, objected because of the likely loss of jobs, exports and GNP growth.

As of February 1999, 12 countries–Uganda, Bolivia, Burkina Faso, Guyana, Cote d'Ivoire, Mozambique and Mali–had been evaluated under the HIPC Initiative:

The Jubilee 2000 proposal builds on the HIPC Initiative in a highly paternal approach, and argues that all debt should be forgiven. The estimated cost to high-income countries would be $400 per man, woman and child. Conscious of the failure of 'conditionality' in the past, the Jubilee 2000 movement focuses on 'new conditionality', notably on poverty alleviation. Much of the 'conditionality' of the past, however, included poverty alleviation; importantly, it also included growth requirements.

It is here that Jubilee 2000's proposals for 'new conditionality' are so weak precisely because they say so little about the basic policies and institutions that are essential to growth. There has been considerable 'forgiveness' of bilateral debt under Paris Club and other auspices; yet accelerated growth and poverty alleviation has not followed. Without radical policy and institutional change, the HIPCs will continue to stagnate and decline. The argument that a new high level of transparency–putting the 'conditions' on the Internet–would make the new 'conditionality' effective is simply too naïve to be taken seriously. Mass access to the Internet is hardly a feature of the HIPCs.

Even debt repudiation would be a better way than seeking debt-forgiveness for a country to make it clear that it intends to change its policies radically. In such a scenario, donors and lenders would have to evaluate whether the policy changes would lead to growth and poverty alleviation that would make grant aid and private loans worthwhile.[2] Most of the knowledge needed to change policies and institutions is in the public domain. The many private consulting firms now working for multilateral institutions could be hired directly by countries intent on changing their policies. Splitting technical assistance from borrowing would be beneficial in terms of transparency and accountability, not least because if the consultants' advice proved useless, they could be dismissed by the governments that they were directly advising. (It has even been suggested that, for incentive purposes, advisers to developing countries should receive their remuneration in the currencies of the countries that they advise.)

The HIPC proposal thus adds to the very considerable 'moral hazard' that is already present in international capital markets because of irresponsible lending by the IMF.

Costs of Debt Forgiveness

Debt 'forgiveness' is neither just nor moral. Because aid flows have been declining, debt forgiveness would mean shifting aid expenditures from well managed to poorly managed countries. This would send the message that failure is to be rewarded and success is to be penalised. Governments least concerned with the welfare of their citizens, and correspondingly the most corrupt, would be forgiven for the misery that they are creating by their rapacious behaviour at the expense of more responsible countries. Poor people in South Asia and China, where their numbers are greatest, would be penalised. Incompetence and greed would be rewarded. The only way to reduce poverty in developing countries is through encouraging rapid growth (Fields 1989). Yet developing countries who are experiencing economic growth would be the losers if debt-forgiveness proceeded in the way envisaged by the HIPC Initiative and Jubilee 2000.

'Forgiving' debt increases borrowing costs by increasing country risk. It anticipates writing debt off again in the future. Increasing country risk would not affect the 40 HIPCs: as their low private borrowing indicates, they are not creditworthy. It would, however, raise the costs of borrowing for other developing countries. Lenders would fear further write-offs. The HIPC proposal thus adds to the very considerable 'moral hazard' that is already present in international capital markets because of irresponsible lending by the IMF, the World Bank and other multilaterals. The costs of borrowing would rise for countries that have managed their affairs well. Many of these, despite the recent problems of crony capitalism, are our neighbours in Asia. These countries used commercial borrowing well to support rapid growth and widespread poverty alleviation in the early 1990s.

Given the histories of the countries on the HIPC list, it is naïve to imagine that tax revenues freed up by the reduction of interest payments abroad will be suddenly switched to funding mass education and health programmes. Even given their present external debt constraints, HIPC countries are already in a position to increase the availability of such services. Indeed, for many HIPC countries, debt is *not* high by international standards. The reason why debt forms a high proportion of budget and exports is that very poor policies and institutions make for unacceptably low revenues and trade. An examination of HIPC government revenues and expenditures actually indicates strong biases against poor people, typified by the fact that almost all HIPCs have disproportionately large military expenditures. The HIPC Initiative for forgiving debt would also leave the beneficiaries highly dependent on further aid, loans or grants without any assurance that economic management would improve. Vietnam, for example,

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2 The experience of populist Latin American governments that repudiated their debts in the 1950s is not a guide to the 1990s search for a just and moral approach to reducing debt. The Latin American governments were moving toward more *dirigiste* policies. As expected, their economic performance declined.

is one of the HIPCs. Its policies are totally inimical to growth and there is no indication of significant policy or institutional change. The Vietnamese people have shown that they are highly entrepreneurial, quick to learn skills and extremely hard working. Yet they are denied the opportunities for a decent life; most Vietnamese are desperately poor because the country is being run for the benefit of an elite of Communist Party cadres. Nonetheless, it is in these circumstances, and without any promise of changes in the Vietnamese Government's policies or institutions, that the World Bank is establishing an office in Vietnam with four staff members. Management is being moved from Washington to Hanoi so that staff can better negotiate 'conditionality' with the cadres who are responsible for the country's misery.

The possibility that writing off debt will enable the HIPCs to go on a new borrowing spree is considerable. Forgiving debt will confer a type of legitimacy upon corrupt and economically irresponsible regimes, and encourage irresponsible dictators and their cronies to attempt to secure new loans.

The Benefits of the HIPC Initiative to Lenders

The principal beneficiaries of the HIPC Initiative would, not surprisingly, be those who designed it: that is, the staff of the IMF, the World Bank and other multilateral institutions.

The HIPC Initiative is largely about re-arranging accounts. This is important for the IMF and the World Bank because, although countries would in fact be defaulting, the Initiative would avoid the declaration of defaults. The IMF and the World Bank believe that forgiving or reducing debt would diminish their assurances of repayment on new lending and hurt their credit ratings. 'In other words, the IMF and the World Bank are unwilling to accept responsibility for past errors by forgiving loans and reforming lending practices that are in large part responsible for "unsustainable" debt burdens in HIPC countries. They think that doing so might harm their ability to pursue those activities in the future' (Schaefer and Froning 1999: 5). In this sense, the HIPC Initiative is not so much a solution to poor countries' debt problems, but rather a way of disguising the failures of the IMF and World Bank.

The HIPCs represent a third or more of the countries in which the IMF and World Bank actively operate. Operations in these countries justify at least a third of staff employment. The service payments on developing countries' debt pay their salaries, associated benefits and travel. If lending were to end to the HIPC countries, at least a third of the staff could become redundant.

The HIPC Initiative has won the support of bureaucrats with multilateral affiliations. Ministries of Finance and Treasuries have traditionally supported multilateral over bilateral aid because of the benefits they gain through appointments to multilateral consulting, staff and executive director positions. The latter also lend themselves to crony political appointments from both developed and developing countries. Moreover, continuing bilateral and multilateral aid flows to the 'borrowed up' countries are important to the finances of non-government organisations that operate in HIPCs and receive substantial subsidies from aid flows to them.

Forgiving debt will confer a type of legitimacy upon corrupt and economically irresponsible regimes, and encourage irresponsible dictators and their cronies to attempt to secure new loans.

Conclusion

In practical terms, debt forgiveness for the HIPCs only concerns public debt. Private debt, except for military debt, is negligible. Public debt falls into two components. Countries that gave aid in the form of loans rather than grants are owed 46 per cent of the HIPCs public debt. Resolving the debt situation is an issue for their governments. Australia's share of this debt, mainly some $60 million owed by Vietnam, is very small. It can be dealt with in the context of the AusAID budget so that funds are not transferred from countries that use aid well to those that use it badly.

The IMF and World Bank are owed 54 per cent of the HIPCs public debt. In coming weeks, the financial world will meet in Washington at the annual meetings of the IMF and the World Bank. The senior staff of these institutions, the world's Ministers of Finance/Treasurers, their top bureaucrats, the world's most prominent bankers and leaders of non-government organisations concerned with forgiving developing country debt will gather together at the giant cocktail party that inaugurates these meetings.

The IMF and the World Bank in this last year of the twentieth century are not reviewing the development progress that they have succeeded in promoting during their half-century of operations; rather, they are critically concerned with the forgiveness of debt to the 40, mostly African, HIPCs. These countries are so heavily borrowed up that unless their debt is forgiven, the IMF and World Bank will have to cease lending to them. Perhaps 3,000 Fund and Bank staff would lose their jobs. This makes the HIPC Initiative critical to these two institutions. But the IMF-World Bank HIPC Initiative does not propose to forgive the HIPCs' debt. Subject to 'conditionality'–which has demonstrably failed to promote growth in the past–debt service is to be paid from special funds drawn from IMF and World Bank profits (i.e., service charges on lending to other developing countries) and from donations by countries such as Australia. By not writing the HIPC debt off, the IMF and World Bank will be able to retain their high credit ratings. Unfortunately, by arranging for the HIPCs' debt service to be paid by other, often only marginally wealthier countries, these two institutions will enable the HIPCs to start borrowing again. While the 'new conditionality' makes much of the language of poverty alleviation, there can be little doubt that the new loans made to the HIPCs will be spent on the same old uses: luxurious lifestyles and 'pensions' for the elites and the purchase of arms to subdue their own citizens and their neighbours.

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